79-1768

No.

Supreme Court, U.S.
FILED
MAY 6 1980
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

JUNE L. MYERS,
Petitioner,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

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St. Louis Law Printing Co., Inc., 411 No. Tenth Street 63101 314-231-4477

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No.

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JUNE L. MYERS,
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UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

Petitioner, June L. Myers respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Ninth Circuit entered in this proceeding on February 11, 1980 and February 12, 1980.

OPINIONS BELOW

The opinion of the Court of Appeals, not yet reported, is annexed hereto as Appendix A. The opinion of the United States District Court for the Central District of California is not officially reported but is unofficially reported at 77-2 U.S.T.C. Paragraph 9593 and is annexed hereto as Appendix B.

JURISDICTION

The judgment of the United States Court of Appeals for the Ninth Circuit was entered on February 11, 1980 and February 12, 1980. The jurisdiction of this Court is invoked under 28 U.S.C. §1254(1). The basis for federal jurisdiction in the court of first instance was 28 U.S.C. §1346(a)(1).

QUESTION PRESENTED

Whether a patent application constitutes depreciable property, so that the transfer of a patent application to a related corporation is precluded from capital gains treatment pursuant to a tax law that causes the gain on the transfer of depreciable property between related taxpayers to be treated as ordinary income.

STATUTE INVOLVED

Section 1239(a) of the Internal Revenue Code of 1954 (26 U.S.C. 1239(a)) reads as follows:

Gain From Sale Of Depreciable Property Between Certain Related Taxpayers

(a) Treatment of Gain as Ordinary Income - In the case of a sale or exchange of property, directly or indirectly, between related persons, any gain recognized to the transferor shall be treated as ordinary income if such property is, in the hands of the transferee, subject to the allowance for depreciation provided in section 167.

This statutory provision was modified by Section 2129(a) of the Tax Reform Act of 1976. The petitioner and the appellant have agreed that the change in statutory language does not affect the case at bar. The parties hereto have stipulated that if Section 1239 does not apply, the taxpayer is entitled to capital gains treatment.

STATEMENT OF THE CASE

This case comes from the United States Court of Appeals for the Ninth Circuit which affirmed a judgment of the United States District Court for the Central District of California filed on July 14, 1977 in favor of the United States of America denying the claim of June L. Myers (taxpayer) for a refund of taxes totalling $52,147.64.

The Patent Application

A patent application for a "coupling for conduits" was filed by John W. Myers on June 28, 1954 (Patent Application No. 439.533). After repeated attempts to secure the patent, the application was rejected and abandoned. Mr. Myers filed a second patent application (No. 777,321) on December 1, 1958 as a continuation of the first application. This second patent application consisted of three claims all of which were rejected by the Examiner on January 30, 1959. This rejection was appealed, and the Examiner's decision was reversed as to two of these claims, claims 1 and 2, on January 2, 1963. The Notice of Allowance for Patent Application No. 777,321 was mailed on January 31, 1963. The Patent Office fee of $30.00 was paid subsequent to June 29, 1963. Patent No. 3,104,120 was issued on September 17, 1963. The payment of this $30.00 was essential to the issuance of the patent.

The Transferors

In September, 1954, John W. Myers assigned and transferred a one-tenth (1/10) interest in the Patent Application and Invention to Brodie Ahlport. John W. Myers died on September 19, 1959, before the patent was obtained. His nine-tenths (9/10) interest in the patent application was community property. His widow, June L. Myers, thereafter qualified as Administratrix of the Estate of John W. Myers. As Administratrix, she intervened in and assumed the prosecution of Patent Application No. 777,321 by notice dated May 29, 1963 and received by the U.S.

Patent Office on June 6, 1963. The undivided 9/10 interest in Patent Application No. 777,321 was assigned by the Estate to June L. Myers by a written agreement dated June 28, 1963. The following day, June 29, 1963, June L. Myers assigned her nine-tenths (9/10) interest in the patent application and Brodie Ahlport assigned his one-tenth (1/10) interest in the patent application to Myers Electric Products, Inc.

The Transferee

The transferee of the patent application was Myers Electric Products, Inc. This corporation was incorporated in California on June 30, 1950. Prior to June 29, 1963, June L. Myers had acquired all of the issued and outstanding stock of the corporation.

REASONS FOR GRANTING THE WRIT

I. The Decision Here Of The Court Of Appeals In The Ninth Circuit Is In Conflict With The Decision Of The Court Of Appeals In The First Circuit In LAN JEN CHU v. COMMISSIONER, 486 F.2d 696 (1973).

The decision by the Court of Appeals in the Ninth Circuit is in direct conflict with the decision of the Court of Appeals in the First Circuit in *Lan Jen Chu* v. *Commissioner,* 486 F.2d 696. The Court of Appeals in the Seventh Circuit reached a result in *Estate of Stahl* v. *Commissioner* 442 F.2d 324 (1971) that is in accord with the decision reached by the Ninth Circuit herein. It is appropriate for this Court to resolve the conflict among the Circuits now that two Circuits have held one way and one Circuit in another way diametrically opposed the first.

The Tax Court in *Estate of William F. Stahl,* 52 T.C. 591 (1969) held simply that the sale of a patent application was not a sale of depreciable property. In overruling the Tax Court on this point the Seventh Circuit in *Estate of Stahl* v. *Commissioner,* supra, developed a novel approach as to the transfer of patent applications. The Court therein developed a concept of "ripened" patent applications, in which patent applications that were considered virtually certain to mature into depreciable patents were themselves treated as depreciable.

Once a notice of allowance has been granted as to a patent, the patent itself may sometimes be secured merely upon the payment of a $30.00 fee, but in other instances the securing of the patent may remain uncertain. Thus, footnote 8 in *Lan Jen Chu* v. *Commissioner* criticizes the Seventh Circuit as to the certainty of securing of the patent:

> "The Seventh Circuit may have been too quick to assume that simply because a Notice of Allowance has been granted, a patent would ultimately issue in due course should the applicant exercise only the 'merest diligence' in 'processing the application'. Under Rule 313 of the Rules of Practice of the United States Patent Office, the allowance may be withdrawn at any time prior to the issuance of letters patent for reasons of mistake on the part of the Patent Office, fraud, illegality in the application or any alleged 'interference' (*i.e.* where some other applicant is claiming the same invention). Had the Seventh Circuit fully considered these potential impediments to the eventual issuance of a patent even after receipt of a Notice of Allowance, it might not have concluded that these patent applications were sufficiently 'matured' for purposes of §1239."

In *Lan Jen Chu* v. *Commissioner* 58 T.C. 598 (1972), the Tax Court "explicitly rejected the government's contention that a patent application could be considered property 'of a character subject to depreciation'..." 486 F.2d 696 at 699. This holding was affirmed by the Court of Appeals in the First Circuit which construed Section 1239 as presently constituted to have *no* application to sales or exchanges of patent applications and is irreconcilable with the Seventh Circuit's holding in *Estate of*

Stahl, supra. By way of dictum the Court in *Lan Jen Chu* pointed out that even under the *Stahl* rationale of "ripened" patent applications, the facts would not dictate a different result.

The facts herein are similar to those in *Lan Jen Chu* v. *Commissioner.* In that case, the taxpayer was informed that six (6) of the eighteen (18) claims appear allowable. This notice was received prior to the transfer of the patent application to a controlled corporation.

In the case at bar, the taxpayer was informed that two (2) of three (3) claims were allowable, and this notice was received prior to the transfer of the patent application to a controlled corporation.

Taking its primary holding at face value that Section 1239 can have no application to sales or exchanges of patent applications, then *Lan Jen Chu* is in conflict with both the Ninth Circuit here and the Seventh Circuit in *Stahl;* and the Ninth Circuit's attempt to distinguish the cases factually cannot lessen this direct conflict where in fact patent applications have been sold or exchanged. In the light of these conflicts the infirmities of Section 1239 in this nether area of property deserve to be resolved by this Court so that proper legislative judgments can be made as to whether or not reform is needed, see *Lan Jen Chu,* supra, at 704.

II. The Decision Of The Court Of Appeals In The Ninth Circuit Is Wrong And Contrary To The Applicable Statute, 26 U.S.C. 1239 (Sec. 1239 Of The Internal Revenue Code).

By it terms, Sec. 1239 applies only to depreciable property. The Ninth Circuit treated the patent application as depreciable property solely to close what it perceived to be a "loophole", capital gain treatment from the sale of a patent application to a controlled corporation. This issue was recognized by the Court of Appeals in *Lan Jen Chu* v. *Commissioner,* 486 F.2d 696 at

700, in its statement that "However, much as we recognize the salutary effect of the government's position, our role as a court is not to formulate tax policy in the first instance, but rather to ensure that the enactments of Congress are implemented in accordance with their intended design." The Court then added "It may well be that reform is needed. But in the exercise of our judicial function, this court cannot legislate in order to accomplish such reform. That obligation must be left to the Congress." 486 F.2d 696 at 704.

It is clear that a patent application inherently lacks all of the essential attributes of depreciability. Since a patent application will either result in a patent or be rejected at some future time, the application lacks a reasonably ascertainable useful life. See Section 1.167(a)-1(b) of the Federal Income Tax Regulations. In addition, a patent application lacks a definable salvage value within the requirements of Section 167(f) of the Internal Revenue Code.

A patent application is analagous to a building under construction and other assets that have not yet reached their final form. The applicable cases are uniform in holding such assets to be non-depreciable.

The Commissioner has asserted that once a Notice of Allowance has been issued the patent can be secured merely upon payment of a fee. Assuming, arguendo, this statement to be valid despite the "potential impediments" to patent issuances recognized in *Lan Jen Chu,* the patent application would then constitute an option to acquire a patent. The depreciability of the underlying asset (the patent) does not make depreciable an option to acquire that asset (the patent application).

CONCLUSION

The Court is presented with an opportunity to resolve a significant and recurring conflict between Circuits on a substantial question. The tax laws of the United States should be applied with uniformity and consistency throughout its borders; it detracts from this principle and makes no sense that taxpayers residing in Boston should be treated differently from those residing in Chicago and Los Angeles where the same issue under the same section of the Internal Revenue Code is involved. In addition, the question is an important one which can be readily resolved with a sparing commitment of this Court's valuable time. In an age of energy crisis, expanding world population and projected food shortages, we must hope that inventive minds will seek out and create new technologies. Many of these will be patentable in the United States for which patent applications must be made. How such patent applications and their transfers will be treated for tax purposes may well have an effect on the willingness of individuals to commit time, money, and effort to developing such technologies. The ability or inability of these individuals to transfer their patent applications at capital gains rates (even where for legitimate business reasons they choose to do business under the separate roof of a controlled corporation) may either encourage or chill their involvement. This Court's opinion may demonstrate to the Congress the need or lack of need for legislative reform and for other and more innovative statutory treatment (as already suggested by one Circuit below); a resolution here will do more than settle the entitlement to $52,147.64 between private litigants. Lastly, the single question presented is not complex, and the record is short with all facts stipulated so that no inordinate call on this Court's resources is involved.

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Ninth Circuit.

Respectfully submitted,

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APPENDIX

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

JUNE L. MYERS,
Plaintiff-Appellant,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee.

NO. 77-3600 CV 76-938 F

OPINION

(Amended First Page)

(FILED Feb. 12, 1959)

Appeal from the United States District Court for the Central District of California

BEFORE: KENNEDY and HUG, Circuit Judges, and CORDOVA*, District Judge

CORDOVA, District Judge:

This is an appeal from a judgment denying June L. Myers (taxpayer) claim for a refund of taxes. The refund claim relates to her royalty proceeds from the transfer of her interest in a patent application and whether such proceeds should be taxed as ordinary income or capital gain. The District Court found that a patent application, for which a "notice of allowance" has been received prior to transfer, had "sufficiently matured" so as to be property subject to an allowance for depreciation and that the proceeds from such transfer are taxable as ordinary income. 26 U.S.C.A. (I.R.C. 1954) §1239(b). We affirm.

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*Honorable Valdemar A. Cordova, United States District Court Judge for the District of Arizona, sitting by designation.

IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ARIZONA

NO. 77-3600
CV 76-938 F

JUNE L. MYERS,
Plaintiff-Appellant,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee.

OPINION

(FILED Feb. 11, 1980)

Appeal from the United States District Court for the Central District of California

BEFORE: KENNEDY AND HUG, Circuit Judges, and CORDOVA*, District Judge

CORDOVA, District Judge;

This is an appeal from a judgment denying June L. Myers' (taxpayer) claim for a refund of taxes. The refund claim relates to her royalty proceeds from the transfer of her interest in a patent application and whether such proceeds should be taxed as ordinary income or capital gain. The District Court found that a patent application, for which a "notice of allowance" has been received prior to transfer, had "sufficiently matured" so as to be property subject to an allowance for depreciation and that the proceeds from such transfer are taxable as ordinary income. 26 U.S.C.A. (I.R.C. 1954) §1239(b). We affirm.

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*Honorable Valdemar A. Cordova, United States District Court Judge for the District of Arizona, sitting by designation.

FACTS:

In the instant action, taxpayer's late husband applied for a patent (Patent Application No. 777,321). On January 31, 1963 the Patent Office issued a formal "notice of allowance" of the patent application and requested the $30.00 final fee be paid for the issuance of Letters Patent. On June 29, 1963 Appellant Myers transferred and granted to Myers Electric Products, Inc., her wholly owned corporation, the "sole and exclusive right, privilege and license to use, manufacture, produce and sell the invention covered by Patent Application No. 777,321 for a period of 20 years." Sometime after the transfer, the final fee was paid and Letters Patent were issued on September 17, 1953.

ISSUE:

The question presented on appeal is whether Patent Application No. 777,321 is property which in the hands of the transferee is of a character which is subject to the allowance for depreciation provided in Section 167 of the Internal Revenue Code of 1954 and whether the gain realized thereby is ordinary income under Section 1239 of the Code.

DISCUSSION:

Section 1239 of the Internal Revenue Code of 1954[1] provides that any gain recognized to the transferor in the sale or exchange of depreciable property, directly or indirectly, to a controlled corporation must be taxed as ordinary income, not as capital gain.

---

[1]Int.Rev.Code of 1954, §1239 provides in pertinent part;

(a) TREATMENT OF GAIN AS ORDINARY INCOME — In the case of a sale or exchange, directly or indirectly, of property described in subsection (b) —

* * *

The legislative intent of §1239 of the Internal Revenue code is evident from the language of the statute itself. It is clear that §1239 was intended to prevent situations in which a taxpayer sells appreciated property at current market price to his controlled corporation, and while keeping control over the property reaps the benefits of both capital gains treatment for himself and depreciation deductions against ordinary income in his controlled corporation. The reason is therefore evident why the transferor's gain should be treated as ordinary income where he transfers depreciable property to his controlled corporation.

Considering the above legislative purpose, this Court is called upon to determine when patent applications mature to the point of becoming depreciable property for the purposes set forth in §1239 of the Internal Revenue Code. It appears that patents go through an evolutionary process which includes the patent application, letter of "appearance of allowability", formal "notice of allowability" and finally issuance of the patent. Generally a patent application represents an assignable property right which is nondepreciable because it has no definite period of useful life. At the other end of the evolutionary process of patents is the issuance of the patent. There is no dispute that a

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(2) between an individual and a corporation more than 80 percent in value of the outstanding stock of which is owned by such individual, his spouse, and his minor children and minor grandchildren;

any gain recognized to the transferor from the sale or exchange of such property which is neither a capital asset nor property described in section 1231.

(b) SECTION APPLICABLE ONLY TO SALE OR EXCHANGE OF DEPRECIABLE PROPERTY. — This section shall apply only in the case of a sale or exchange by a transferor of property which is subject to the allowance for depreciation provided in section 167.

* * *

patent is property, is depreciable and falls within the purview of §1239. *Hershey Mfg. Co.* v. *Commissioner,* 43 F.2d 298 (10th Cir. 1930). We concern ourselves with a consideration of those situations between the filing of the patent application and the final issuance of the letters patent.

Appellant Myers contends and relies upon the generally accepted rule that patent applications are not depreciable property and not subject to ordinary income treatment. Appellant further urges in conformity with this general rule that for tax purposes, the boundary line between a patent application and the patent itself cannot be crossed until letters patent are actually issued. At first blush, this reasoning would appear to be logical; we must look, however, to the legislative intent to resolve the issue presented.

To accept Appellant's theory would mean that a taxpayer upon receipt of the formal "notice of allowability" could by simply delaying the payment of the final patent fee insure the receipt of capital gain treatment by transferring his right, title and interest in the patent application to a corporation wherein he owns more than 80 percent in value of the outstanding stock.

There comes a point in some patent applications where the possibility of issuance of letters patent is overtaken by the probability of such issuance. The appropriate standard to be applied to cases similarly situated as the one before us now has been set forth in the *Estate of Stahl* v. *Commissioner,* 442 F.2d 324 (8th Cir. 1971). This Court expressly adopts that part of the rationale of *Stahl* which provides that patent applications as to which official notices of allowance have been received by the transferor prior to the sale are sufficiently matured applications so as to require that they be treated as patents for the purposes of §1239. The *Stahl* court realized, as we do, that where patent applications are virtually certain to mature into depreciable patents with the merest of diligence by the transferee in process-

ing the applications after the sale, a mechanistic distinction between patents and those patent applications which have been the subject of official indications of allowability is unwarranted.

Appellant attempts to respond to the rationale of *Stahl* with the later 1st Circuit case of *Chu* v. *Commissioner,* 486 F.2d 696 (1st Cir. 1973). We first note that in *Chu* the taxpayer had merely received notification of a possibility of the issuance of the patent by receipt of a letter of "appearance of allowability" and had not received the probability of issuance of the patent in that he had not received the formal "notice of allowability". While we may not agree with taxpayer's contention that *Chu* expressly rejected the decision in *Stahl,* it is enough that we find the two cases factually distinguishable. In *Chu,* the applicant assigned his patent application after the Patent Office informed him that only six minor claims of eighteen claims "appeared allowable", while the heart of the patent had been rejected. Thereafter, an amended application was filed which was followed by a "notice of allowance" and then the patent. The *Chu* court attempted to apply *Stahl* but could not since the "notice of allowance" as to the heart of the application was not issued until after the transfer.

Appellant further contends that she either relied or had the right to rely on the law as it existed at the time of the transfer. The relevant law as it existed in 1963 was Section 1239 and the regulations thereunder. Taxpayer relies on a Solicitor's Memorandum, SM 5038 CB V-1, released by the Treasury Department, which generally stated that applications for letters patent are not property which is subject to depreciation.

It is conceded by the parties that at the time of the transfer there was no case law directly on point. Appellant argues that it was not until a 1967 Revenue Ruling, Rev.Rule 67-136, 1967-1 CB, 58, that the Government recognized that patent applications are subject to depreciation when a patent will issue in the "normal course" of events.

Taxpayer's position herein, however, ignores the facts before us. The record clearly indicates that the tax return in question was filed by her treating the proceeds as ordinary income. At the time her tax return was filed she treated the income as ordinary income and obviously did not rely on the Solicitor's Memorandum. The Appellant's contention of reliance is therefore not a viable issue in this case. As to whether Appellant had a right to rely on the law (Solicitor's Memorandum) is a purely academic question which this Court need not address.

Accordingly, this Court finds that upon payment of the final fee, the patent would have issued, as indeed it did, in the normal course of events. Under these circumstances, the patent application had "matured" and was subject to an allowance for depreciation under Section 167 of the Internal Revenue Code. Since the application herein had matured and was properly characterized as depreciable property by the trial court, the proceeds therefrom were subject to tax as ordinary income when transferred by Appellant Myers to her wholly owned corporation.

AFFIRMED.

APPENDIX B

June L. Myers, Plaintiff v. **United States of America, Defendant.** U.S. District Court, Cen. Dist. Calif., No. CV 76-938-F, 7/14/77.

Findings of Fact and Conclusions of Law

FERGUSON, District Judge: This matter came on for hearing before the Court without a jury on June 27, 1977. Based upon the argument of counsel, briefs, the stipulated facts, and all other matters properly a part of the record in this case, the Court makes the following findings of fact and conclusions of law.

Findings of Fact

1. John W. Myers and June L. Myuers were married on August 11, 1940, and such marriage continued until the death of John W. Myers on September 19, 1959. June L. Myers thereafter married Louis Carl Breer on December 31, 1963 and remained married to Mr. Breer until a final decree of divorce was obtained on April 12, 1971. June L. Myers and Louis Carl Breer filed joint federal income tax returns for the years 1967 and 1968. Mrs. Myers filed a separate return for 1969 and an unmarried head of household return for the years 1970 through 1973. June L. Myers filed her federal income tax returns for the years 1967 through 1973 with the Internal Revenue Service Center at Ogden, Utah or Fresno, California. Her income was reported on the cash receipts and disbursements method of accounting.

2. John W. Myers began working on ideas and drawings for a "coupling for conduits" in the early 1950's. Mr. Myers worked nights and weekends in a friend's small hobby machine shop to develop samples of the product. The invention was first introduced to the market in February, 1955 and was thus reduced to actual practice in said month. The coupling for conduit was

designed to join electrical conduit pipe to the sheet metal wall of a switch box or the like. Mr. Myers' coupling was superior to other products on the market in that it met in a simple and inexpensive manner the three principal requirements for such couplings specified in the then existing electrical codes; (1) low electrical resistance through the couplings; (2) capacity to withstand high torque; and (3) that the coupling be completely weatherproof.

3. John W. Myers first filed a patent application with respect to said invention on June 28, 1954 (Patent Application No. 439,533). Mr. Myers filed a second Patent Application which was a continuation of No. 439,533 on December 1, 1958 (Patent Application No. 777,321), and Patent Application No. 439,533 was thereafter abandoned. Patent Application No. 777,321 consisted of three claims, and all of these claims were rejected by the Examiner on January 30, 1959. Said rejection was appealed, and the Examiner's decision was reversed by the Board of Appeals as to claims 1 and 2 on January 2, 1963. A Notice of Allowance with respect to Patent Application No. 777,321 was mailed on January 31, 1963.

4. John W. Myers died on September 19, 1959 before a patent could be obtained for his invention. The Patent Application was community property. His widow, June L. Myers, thereafter qualified as the Administratrix of the Estate of John W. Myers, and as such, intervened and assumed the prosecution of Patent Application No. 777,321 by notice dated May 29, 1963 (received by the U.S. Patent Office on June 6, 1963). June L. Myers, as Administratrix of the Estate of John W. Myers, by written assignment dated June 28, 1963, assigned the Estate's undivided nine-tenth (9/10) interest in Patent Application No. 777,321 to June L. Myers. John W. Myers had in September, 1954 assigned and transferred a one-tenth (1/10) interest in said Patent Application and invention to Brodie Ahlport.

5 Myers Electric Products, Inc. was incorporated in California on June 30, 1950, and on June 29, 1963, June L. Myers own-

ed all of the issued and outstanding stock of said corporation. June L. Myers, Brodie Ahlport, and Myers Electric Products, Inc. executed an agreement on June 29, 1963 by which June L. Myers and Brodie Ahlport granted Myers' Electric Products, Inc. "the sole and exclusive right, privilege and license to use, manufacture, produce, distribute and sell" the invention covered by Patent Application No. 777,321 for a period of twenty (20) years. In exchange for said transfer, Myers Electric Products, Inc. agreed to pay June L. Myers and Brodie Ahlport a royalty of four per cent (4%) of all gross sales of said invention, except that a royalty of five per cent (5%) would be paid on all such sales in excess of $1,000,000.00 in any one year.

6. After June 29, 1963, Myers Electric Products, Inc. paid the final government fee of $30.00 to the Patent Office and the payment of such fee was essential to the issuance of the Letters Patent. Letters Patent were issued with respect to patent Application No. 777,321 on September 17, 1963 (Patent No. 3,104, 120).

7. June L. Myers' (hereinafter "Taxpayer") basis for her rights in Patent Application No. 777,321 was $65,000.00. Royalties received in 1963 and 1964 exceeded $65,000.00, so Taxpayer's basis in Patent Application No. 777,321 was exhausted in 1964.

8. Taxpayer filed timely federal income tax returns for the years 1967 through 1970 showing proceeds from the sale of Patent Application No. 777,321 as follows:

Year	Proceeds
1967	$23,619.00
1968	$15,417.00
1969	$53,257.00
1970	$33,641.00

9. Taxpayer reported the above proceeds as ordinary income and paid the following taxes reported due on her federal income tax returns for the years 1967 through 1970:

Year	Federal Income Taxes Paid
1967	$10,035.00
1968	$25,925.00
1969	$12,183.00
1970	$ 7,009.00

10. If Taxpayer was entitled to report the proceeds set forth in paragraph 8 as capital gain rather than ordinary income, Taxpayer made an overpayment of federal income taxes for such years in the following amounts:

Year	Overpayment
1967	$ 4,980.00
1968	$ 4,141.00
1969	$13,001.00
1970	$ 6,378.00

11. Taxpayer's federal income tax returns for the years 1967 through 1970 were all audited, and deficiencies plus interest were assessed on June 3, 1974 as follows:

Year	Deficiency	Interest	Total
1967	$2,169.00	$789.04	$2,958.04
1968	838.00	254.57	1,092.57
1969	2,702.00	658.69	3,360.69
1970	1,656.00	304.34	1,960.34
			$9,371.64

12. On or about June 10, 1974, Taxpayer paid no part of said assessed deficiencies plus interest in the amount of $9,371.64 out of her own separate property funds by check dated June 10, 1974. Louis Carl Breer paid no part of said assessed deficiencies plus interest.

13. On the grounds that the proceeds from the sale of Patent Application No. 777,321 for the years 1967 through 1970 should have been reported as capital gain rather than ordinary income, Taxpayer on August 1, 1975 filed timely claims for refund for an amount equal to the amount of the deficiencies plus assessed interest set forth in paragraph 11 above for the years 1967 through 1970. As a result of the statute of limitations with respect to claims for refund, Taxpayer's claims for refund for the years 1967 through 1970 were limited to the amount of tax plus interest paid within two years of the claims for refund rather than the entire amount of the overpayment as set forth in paragraph 10 above.

14. Taxpayer filed timely federal income tax returns for the years 1971 through 1973. Taxpayer received proceeds from the sale of Patent Application No. 777,321 in the following amount during 1971 through 1973 which were reported on Taxpayer's federal income tax returns as ordinary income:

Year	Proceeds
1971	$58,427.00
1972	$49,421.00
1973	$68,835.00

15. If Taxpayer was entitled to report the above proceeds as capital gain rather than ordinary income, Taxpayer made an overpayment of federal income taxes for the years 1971 through 1973 as follows:

Year	Overpayment
1971	$15,555.00
1972	$10,846.00
1973	$16,375.00

16. The Internal Revenue Service neither allowed nor disallowed any of the above-described claims for refund within six months of their filing.

17. Any conclusion of law more properly considered as a finding of fact shall be considered here as a finding of fact.

Conclusions of Law

1. In this, as in all federal tax refund cases, the established rule is that the determination of the Internal Revenue Service is presumed to be correct and the burden is on the taxpayer to prove entitlement to recovery. *Lewis* v. *Reynolds,* 284 U. S. 281 (1932); *Vulcan Materials Co.* v. *United States* [71-1 USTC ¶ 9449], 446 F.2d 690 (5th Cir. 1971); *Martin* v. *United States* [69-1 USTC ¶ 9463], 411 F.2d 1164 (8th Cir. 1969); *Roybark* v. *United States* [55-1 USTC ¶ 9122], 218 F.2d 164 (9th Cir. 1954).

2. In the case of a sale or exchange, directly or indirectly of property which in the hands of the transferee is property of a character which is subject to the allowance for depreciation provided for in 26 U. S. C. Section 167, between an individual and a corporation more than 80 percent in value of the outstanding stock of which is owned by such individual, any gain recognized to the transferor from the sale or exchange of such property shall be considered as gain from the sale or exchange of property which is neither a capital asset nor property described in section 1231. 26 U. S. C. section 1239.

3. The purpose of Section 1239 is designed to prevent situations in which a taxpayer, who owns property having a market value substantially in excess of its depreciable basis, sells it at market price to the controlled corporation. Thus, while keeping control over the property, the taxpayer exchanges for capital gains tax on the profit from the sale, depreciation deductions against ordinary income for the corporation to enjoy. S. Rep. No. 781, 82d Cong., 1st Sess., p. 69 (1951-2 *Cum. Bull.* 458, 507).

4. The patent application in this case, which was transferred 5 months after the Notice of Allowance was received from the

U. S. Patent Office, and with respect to which the patent was granted only 3 months after the transfer, requiring of the transferee merely the paying of the $30 fee, was sufficiently matured so as to consider the transfer as having been one of a property which was of a character subject to the allowance for depreciation under 26 U. S. C. section 167. *Estate of Stahl* v. *Commissioner* [74-1 USTC ¶ 9322], 442 F.2d 324 (7th Cir. 1971). See also *Davis* v. *Commissioner,* [74-1 USTC ¶ 9231], 491 F.2d 709 (6th Cir. 1974).

5. The capital gains provisions are to be narrowly limited to the situations for which their benefits were intended. Section 1239 represents an express Congressional identification of a situation in which capital gains benefit are not to be enjoyed. Therefore, upon broadly construing the phrase "property of a character which is subject to the allowance for depreciation" (so as to narrowly limit the class of transactions qualifying for capital gains), it is altogether reasonable to view the patent application involved here, as well as the circumstances relating to its transfer, as being specifically contemplated by section 1239. *Commissioner* v. *Gillette Motor Co.* [60-2 USTC ¶ 9566], 364 U. S. 130 (1960); *Corn Products Co.* v. *Commissioner* [55-2 USTC ¶ 9746], 350 U. S. 46 (1955).

6. Any finding of fact more properly considered as a conclusion of law shall be considered here as a conclusion of law.

Judgment

This matter came on for hearing before the Court without a jury on June 27, 1977. Based upon the *Findings of Fact* and *Conclusions of Law* on file in this case,

IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that plaintiff's Complaint for Refund of Income Tax, and the action, be dismissed, and that defendant recover its costs of suit.